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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 8

UNITED STATES OF AMERICA, PETITIONER

v.

BETHLEHEM STEEL CORPORATION, BETHLEHEM SHIPBUILDING CORPORATION, LTD., BETHLEHEM STEEL COMPANY, FORE RIVER SHIPBUILDING CORPORATION, UNION IRON WORKS COMPANY

No. 9

UNITED STATES SHIPPING BOARD MERCHANT FLEET CORPORATION, PETITIONER

v.

BETHLEHEM SHIPBUILDING CORPORATION, LTD.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR THE UNITED STATES AND THE UNITED STATES SHIPPING BOARD MERCHANT FLEET CORPORATION

I

ITEMS NOT IN DISPUTE

Respondents' brief (pp. 16–17) correctly states that $1,514,994.93 of the judgment awarded Beth-

lehem in the action at law is concededly due under contracts other than those now under attack. That amount may, therefore, properly be deducted from any recovery to which petitioners may be held entitled.

II

THE ISSUES PRESENTED ARE PROPERLY BEFORE THE COURT

Respondents' brief (pp. 3–7) asserts that none of the grounds upon which petitioners now seek relief was within the issues tendered by the pleadings. The claim is that the Government's original pleadings were predicated entirely upon a charge of fraud, and that no contention was made that the payment of the bonus for savings to respondents was unconscionable in the circumstances, that the Government accepted the contracts under duress, or that the bonus provisions permit respondents to recover only for savings resulting from extra efforts or increased efficiency.

There can be no doubt that the contentions advanced by the Government are properly before the Court for determination.

(a) *Unconscionability.*—Our contention that it would be unconscionable to permit respondents to recover the grossly excessive profits arising out of the bonus-for-savings clause is adequately described in substantially the same language both in the Government's affidavit of defense to the suit at law (R. 398) and in the Government's bill

of complaint in equity (R. 1960–1961). The affidavit of defense avers that (R. 398)—

> whatever provisions might be contained in the said contracts to the contrary notwithstanding, the plaintiff, Bethlehem Shipbuilding Corporation, Ltd., was entitled to receive from the United States only a fair and reasonable profit upon the work done, and that any term, covenant, or provision in any such contract for the payment of any sum in excess of a fair and reasonable profit upon the fair and reasonable cost of the work was and is void and uninforceable.

The opinion of the District Court (R. 738) summarized the Government's contention on this point as follows:

> The contract, although without any element of fraudulent deception in its making, in its performance results in profits to the contractor, so inordinately large as to be extortionate and to render the contract unconscionable and thus unenforceable in Equity or at Law.

The court then stated (R. 738):

> This is the real cause of action set up in the Bill and the real defense interposed to the action at law. * * *

The argument as to unconscionability was treated at some length in the Master's report (R. 539–540), the opinion of the District Court (R. 738–742), the opinion of the Circuit Court of Appeals

(R. 2328–2329), and the briefs of both parties in the District Court and the Circuit Court of Appeals.[1]

(b) *Duress.*—The Government's argument that Bethlehem's insistence that the Government accept this form of contract under the conditions existing in 1917 and 1918 brought the case within the common law doctrine as to contracts made under duress is based upon the facts alleged in the pleadings (R. 395–396; 1957–1959), brought out at the trial, and described in the Master's report (R. 539) and the opinion of the Circuit Court of Appeals (R. 2323, 2327–2328). These facts are in substance the same as those supporting the argument that enforcement of the contracts is unconscionable. The close relationship between the two propositions appears from the illustration which the District Court viewed as analogous to the Government's position on unconscionability, that of a drowning man who contracts to pay an inordinate reward to a rescuer (R. 738). The illustration is, of course, a typical case of a contract unenforceable because made under duress.

(c) *The construction of the contract.*—Although there are general allegations that any term of the

[1] See the Government's brief in the District Court (pp. 95–108), Bethlehem's brief in the District Court (pp. 90–108), the Government's brief in the Circuit Court of Appeals (pp. 29–44), and Bethlehem's brief in the Circuit Court of Appeals (pp. 82–96).

contracts allowing Bethlehem more than a reasonable profit is void and unenforceable (R. 398, 1960–1961), our argument that the contracts permit bonus payments only for savings resulting from special effort or increased efficiency is not specifically set forth in the Government's pleadings. But the facts showing the intention of the parties in making the contracts were placed in evidence, and our position was squarely presented to and passed upon by the Master (R. 636–638), the District Court (R. 737), and the Circuit Court of Appeals (R. 2329–2330). Indeed, Bethlehem's brief in the Circuit Court of Appeals (p. 20) stated that "the same contention was made in the Court below and was repudiated both by the Master and by the Court." The point was considered at length in the briefs of both parties in the two lower courts.[2]

Respondents' brief nowhere states that they were in any way prejudiced or misled by the alleged variance in the Government's case, or that the points in question were not covered by the evidence, treated in the Master's findings, or considered in the opinions and briefs in the District Court and the Circuit Court of Appeals. Clearly the lengthy record in this case fully explores all

[2] The point was treated in the Government's brief in the District Court (pp. 108–118), in Bethlehem's brief in the District Court (pp. 28–55), in the Government's brief in the Circuit Court of Appeals (pp. 15–24), and in Bethlehem's brief in the Circuit Court of Appeals (pp. 19–43).

of the circumstances under which the contracts were made.

In this situation any possible variance between the allegations in the Government's pleadings and the proof and arguments presented in the lower courts would no longer be material. For the rule has long been "that no variance between the allegation of a pleading and the proofs offered to sustain it, shall be deemed material, unless it be of a character to mislead the opposite party in maintaining his action or defense on the merits."[8] *Nash* v. *Towne,* 5 Wall. 689, 698; *Standard Oil Co.* v. *Brown,* 218 U. S. 78, 84; *Reynolds* v. *Stockton,* 140 U. S. 255, 266; *Jennings* v. *Philadelphia,* 117 Pa. Sup. 462, 470; *Calvey* v. *Coyer,* 121 Pa. Sup. 504, 508–509. "In a contested case there must be an entire abandonment of the very substance of the dispute to which the defendant was summoned, and the substitution of another which he can not have anticipated, and which he had

[8] Since the time of their organization the Federal courts have been directed to give judgment according to law and the right of the cause. *Nash* v. *Towne,* 5 Wall. 689, 698; Act of September 24, 1789, c. 20, Sec. 32, 1 Stat. 72, 91. This principle is now embodied in two of the Federal Rules of Civil Procedure which provide specifically that "When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings" (Rule 15 (b)), and that "every final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in his pleadings" (Rule 54 (c)).

no opportunity to meet" before a judgment is to be upset for variance. *Armand Co.* v. *Federal Trade Commission,* 84 F. (2d) 973, 974–975 (C. C. A. 2d), certiorari denied, 299 U. S. 597. And this Court has even held that it may properly consider issues never presented to the tribunal of first instance. *Hormel* v. *Helvering,* 312 U. S. 552; *United States* v. *Wilhams,* 278 U. S. 255; *Helvering* v. *Leonard,* 310 U. S. 80, 83.

III

THE GOVERNMENT'S POSITION

Respondent's brief (pp. 4–6) purports to state the Government's contentions in a manner which is both inaccurate and confusing. In order that the Court may be under no misapprehension as to what the Government's position is, our argument is summarized here.

1. It is unconscionable to permit the recovery, under the circumstances disclosed by the present record, of profits of 22 to 26 percent. The circumstances to which we refer are these:

(a) The contracts were cost-plus contracts under which respondents ran no risk of loss but on the contrary were guaranteed at least a 10 percent profit even before the savings clause in question became operative.

(b) The normal fair standard of profits on straight cost-plus contracts was known to be approximately 10 percent (see petitioners' main

brief, p. 54). The respondents thus are claiming more than twice the compensation generally regarded as fair for the riskless services rendered.

(c) The danger of increase of costs under a straight cost-plus contract involved no risk of loss to the contractor but only to the Government. Bethlehem, however, insisted upon the arrangement finally adopted and would accept no contract without the bonus-for-savings provision based upon liberally estimated cost (R. 624, 642–643, 738, 1188, 1355, 1425).

(d) In view of the need to produce ships as rapidly as possible to win the War and the fact that Bethlehem was the largest shipbuilder in the world, the Government was compelled to utilize Bethlehem's services and was not in the position of one freely bargaining on an open or competitive market. See petitioners' main brief, pp. 63–67.

(e) Bethlehem's object from the beginning was that the estimated cost would be sufficiently high to "offer a reasonable probability" of 25 percent profit, enough to leave a net of 10 percent after the payment of war and excess profits taxes amounting to about 60 percent (R. 579, Ex. G–104, R. 1808, 1437–1438).

(f) It was impossible at the time to make an estimate which was more than an "educated guess" (R. 619) as to the actual cost of construction, the range of possible error being concededly as much as 75 percent (R. 1349–1354, 1345, 1496–

1498, 1611–1613). Thus the estimates which Bethlehem insisted upon were "reasonable" only because an accurate estimate was impossible and hence almost any estimate would have been reasonable.

(g) None of the difference between estimated and actual costs in the performance of the contracts in question were shown to have resulted from any special efforts or increased efficiency induced by the making of this type of contract.[4] See petitioner's main brief, pp. 23–31.

2. Respondents' original offer indicated that the form of contract would give a "reasonable probability" (R. 579, 1808) of a 25 percent profit, and the estimates were concededly so liberal as that "savings" would certainly result under normally efficient operations. This corroborates the view, now supported by Bethlehem's brief (p. 15), that the bonus-for-savings clause, construed as Bethlehem claims it should be, amounts not to compensation for special efforts but to additional remuneration for the performance which a person would have been legally and morally obligated to

[4] If it is true, as Bethlehem contends and we deny, that it is now impossible to tell what the costs would have been if the bonus-for-savings clause "incentive" had not been included in the contracts, it is only because Bethlehem, by adamantly insisting on this type of contract, has made it so. As Bethlehem is thus responsible for the supposed difficulty, the burden of proving the impossibility and the consequence for it if it exists should rest on Bethlehem and not on its victim.

render under a straight cost plus 10 percent contract. In this view, the bonus operates merely as an incentive to prevent the waste, padding, carelessness, and abnormal inefficiency which might result from a straight cost-plus arrangement. The provision thus amounts to no more than a bribe to cause a contractor to exercise normal honesty and efficiency. Under such a contract, the Government is paying an extra sum for what it would have been entitled to in any event—the faithful, honest performance of the contract at standards customary in the business. Irrespective of whether the agreement to pay an extra sum is without consideration in a technical sense, the employment of such a device to take advantage of the necessities of the Government in wartime in order to reap even the "reasonable probability" of an excessive profit is contrary to public morals and should not be countenanced.

3. It may be objected that (a) the Court should not overturn the judgment of the administrative agency responsible for getting ships built and that (b) the bonus-for-savings contracts were reasonable when judged by the then prevailing practice of business. It is true that contracting officials of the Government might feel that as a matter of practical experience in some instances it is worth while to pay extra for an incentive to protect the Government against excessive cost due to waste, carelessness, and dishonesty in the performance of cost-plus contracts and that such

protection outweighs in importance the danger that the Government will pay an exorbitant price. Nevertheless, while the Government may thus have a proper interest in protecting itself through such a device, the contractor, who would be completely safeguarded against risk of loss by an ordinary cost-plus contract, has no legitimate reason for insisting upon additional payment for performing what would in any event have been his duty. Here, the Court is not required to substitute its judgment for that of the Government officials. For in this case it was Bethlehem, not the Government, which proposed and insisted upon the bonus-for-savings type of contract, and which refused to construct ships upon any other basis (see petitioner's main brief, pp. 63–67). And Bethlehem cannot seriously suggest that it was the common practice of persons contracting with the Government to demand as a condition of contracting a bonus-for-savings clause to enhance the probable profits. It is our position that under these circumstances such a contract forced upon the Government by Bethlehem for the avowed purpose of probably producing an excessive profit is so unconscionable and unreasonable that a court should not enforce it.

4. We do not contend, however, that, even in the circumstances of this case, the bonus-for-savings provisions necessarily render the contracts invalid. They may be construed, as they have been by the Court of Claims (see petitioner's

main brief, pp. 39–42, 46–48), as allowing recovery under the bonus clause of half of all savings due to special efforts or increased efficiency, that is, performance over and above the normal. Such a construction conforms to what the Master found (R. 638) and Powell declared to be the purpose (R. 1369) of that particular type of contract. The Court of Claims cases permitting recovery of savings resulting from increased efficiency demonstrate that there is nothing impracticable in applying such a standard. There is a total failure of proof of such savings in this case. See petitioner's main brief, pp. 23–31.

IV

THE OFFER TO PIEZ PERSONALLY AMOUNTED TO NO MORE THAN A GESTURE

Respondents' argument that Powell's offer to let Piez personally fix the terms of the contracts demonstrates that the Government was not compelled to accept Bethlehem's terms is met at page 65 of our main brief. We wish to emphasize, however, that the record demonstrates that not only the Master, the District Court, and the Circuit Court of Appeals, but even Piez himself did not treat the offer as more than a formal gesture.

The Master and the two lower courts found that (in the language of the Circuit Court of Appeals) the Government was "obliged to accept the terms offered by Bethlehem" (R. 2328, 738, 538–539, 627, 643, 574–575). These findings that

the Government needed Bethlehem's services and that it had no option but to accept Bethlehem's final offer cannot be reconciled with the contention that the offers to Piez changed the situation theretofore existing. Indeed, when the offers were made, Piez did not even inform his subordinates who were carrying on the negotiations, Bowles and Radford, or make any other use of the power granted to him; he merely told Powell to continue negotiating with Bowles (R. 1363–1365, 1624, 1527).

The findings of the Master and the two lower courts with respect to the Government's lack of freedom to refuse Bethlehem's terms have not been challenged. They must be accepted as manifesting a consistent understanding by the triers of fact that the offers to Piez were not and were not intended to be acted upon or of substantive consequence.

Respectfully submitted.

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